RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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June 15, 1988 **LETTER 993**

June 3 DJIA 2071.30; PTI 2706; A-D Ratio -9.49
June 10 DJIA 2101.71; PTI 2716; A-D Ratio -8.90
Current Dow yield: 3.54%; Dow P/E: 14.5
Dow 200-day mov aver: 2072; DowPow: 920

THE MARKETS: Let's examine some categories. First **Commodities:** This is the place where everyone is looking. The grains have exploded with soybeans going over $8 a bushel, a four-year high, wheat going over 3.60, and the rest of the grains following (much of it due to the severe drought in the Midwest). At the same time, platinum surged over 600, while the rest of the metals (silver, palladium, copper, aluminum) are strong. Gold almost alone is sluggish, finally dragging itself to the 460 level, then falling back. Crude oil hangs around 17.50 and seems to be going nowhere. Meanwhile, the widely-watched CRB Commodities Futures Index spurted above 260, and Wall Street is asking the big question -- has inflation arrived? The uncertain answer seems to be, "Well, maybe."

Next question: "What might the Fed do about it, if anything?" So far the Fed has been dragging its feet -- afraid to stifle the lop-sided business "boom" and afraid to upset the fragile credit markets (with particular reference to the sickly picture in the banking and savings & loan areas). Can the Fed continue to hold off? It really doesn't matter, because today it's the bond market that decides interest rates, not the Fed.

Bonds: I've said this repeatedly, and I'll repeat it -- the bond and credit markets are running the economy. All eyes are on the T-bonds, and so far they have pushed (on the long-end) up to the 9.3% to 9.5% yield area. If the bond market really starts worrying about inflation, the long rates will push up to and above 10% (at that point the Fed will reluctantly have to follow). Two items (so far) lend ammunition to the "no big inflation" school: (1) bonds are acting quite well, and (2) gold has been very sluggish.

Stock Market: This week's news: On June 10 my Primary Trend Index rose to a post-crash high of 2716. The trend of the PTI therefore continues bullish. There have been instances in the past when the Dow refused to confirm new highs in the PTI and trouble ensued. Nevertheless, a continued rising trend in the PTI must be construed as bullish for the market.

The D-J Averages have now spent eight months fluctuating between the October crash lows of 1738.74 (Industrials) and 740.25 (Transports) and the 1988 highs of 904.12 recorded by the Transports on March 12 and 2110.08 recorded by the Industrials on April 12.

Wall Street knows that 1988 is an "8" year (i.e., a year ending in 8) and also an election year (both items are favorable for the market). Wall Street also notes that it has been eight months since the crash lows, and the market has had every opportunity to fall apart, and has refused to do so. If the market won't go down, well, it should go up. The problem: To get the Dow over 2110.08 with (and this is important) a Transport confirmation over the 904.12 level. Will it happen?

Question: If the Dow closes above 2110.08 confirmed with a Transport close above 904.12, would this be a primary bull market signal?

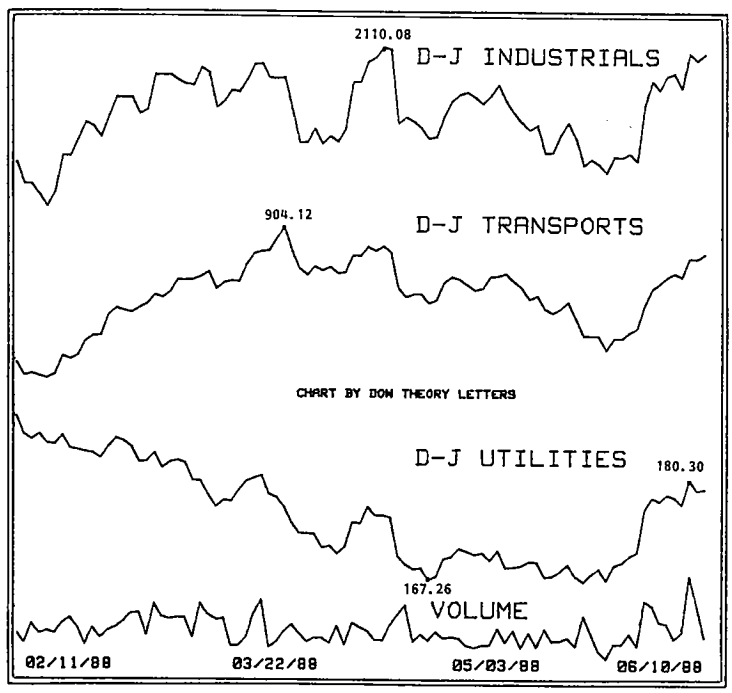
Answer: I can't over-emphasize the importance of the following statement -- ***a bull signal is only valid if it comes following the third and final phase of a bear market*** (as happened, for instance, during early-1975). Phase identification is critical under Dow Theory and many costly mistakes have been made by amateur technicians and neophyte Dow Theorists who took no note of the market phases.

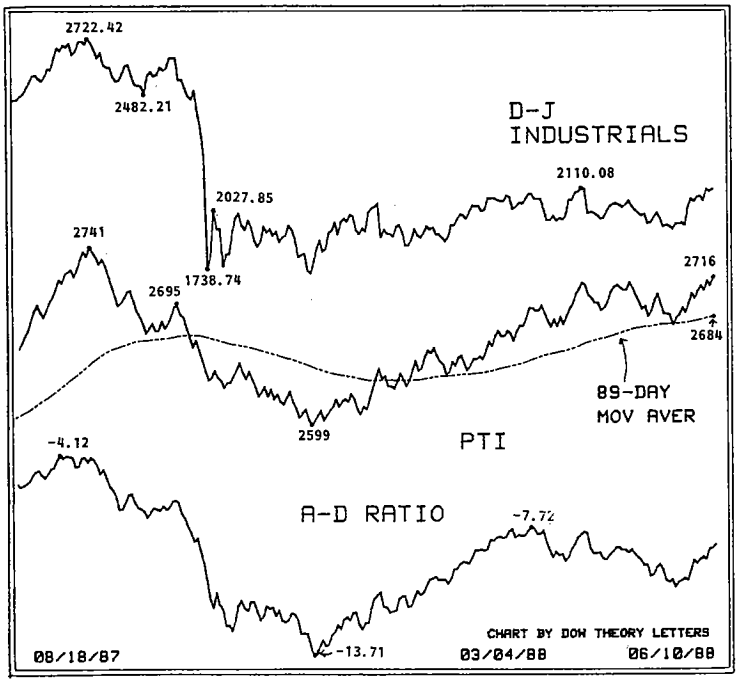
As I have explained many times, this bear market is still in its first phase. Any mechanical "bull signal" that is produced here may be a prediction of higher prices, but such a signal would not mean that we were in a new bull market.

I warned over and over again in previous Letters that this bear market is fated to be difficult, deceptive, and extended. And that's exactly what it's been so far. So I am warning my subscribers again. Expect to hear such cries as "it's a new bull market," "the US market will follow the Japanese market," and "buy 'em now before they run to the moon." But in the end, the bear will reign supreme and most of today's eager-buyers and in-and-out traders will have been destroyed.

This is still a primary bear market, and rallies in bear markets are always dangerous and suspect. Therefore, despite the twin pluses of an election year and the "8" year, I prefer to respect the bear. Speaking for myself, I opt to stay out, regardless of what this market decides to do. Besides, with 5-year T-notes providing yields of around 8.1%, and longer-term T-bonds yielding 8.9%, I don't feel pressured to rush into a stock market yielding 3.5% in the hopes of catching a rally (no matter how big), a rally which is positioned against the primary trend.

As I see it, the critical background item for the stock market at this time is the direction of interest rates. For hints of the direction, we have to watch the action of both the D-J 20 Bond Average and the Utility Average. I feel a downtrend in both of these Averages will say "finis" to any attempt at a serious summer rally. On the other





hand, if the bonds and the utilities can stabilize or at least not go lower, the odds for a rally and maybe a good one increase considerably.

Let me put it another way. I think the markets are so concerned about inflation and interest rates that any rise in either will put immediate pressure on the stock market. On the other hand, a refusal of rates to rise would allow for an advance in stocks.

Question: Russell, if inflation is just around the corner, why in the world isn't gold taking off?

Answer: The US continues to run disgraceful federal deficits of upwards of $150 billion a year, while the trade deficit continues to average $10 billion or more a month. These deficits have foreign holders of US dollars, bonds, and property frightened. Today, America's prosperity is based on the continued willingness of foreigners to buy our debt. But foreign holders of US dollars, bonds, and property are skeptical. Furthermore, they are now slinking toward the exits, and they are cutting back sharply on purchases of US debt. For instance, two years ago the Japanese were buying around $10 billion of US bonds each month. But Japanese purchases of bonds have dropped to less than $1 billion in some recent months!

Our foreign creditors are waiting to see whether anything will be done before the election (even if just in words) or after the election (most definitely in action). If nothing happens, the dollar is going to start sliding again, and a sliding dollar is going to send US interest rates up, up and away. Thus, continued neglect on the deficit front (see news clip below) is going to be **DEFLATIONARY** (that's right, deflationary) in that rising rates will cut off US prosperity like a buzz saw going through a log.

The Bush-Dukakis Pact: Mum's the Word on the Deficit

Neither campaign is needling the other on the budget

By Paul Taylor
Washington Post Staff Writer

As Vice President Bush and Massachusetts Gov. Michael S. Dukakis stalk one another for weaknesses, neither needs to probe too deeply to find that his rival's economic platform has the same hole as his own: no credible deficit-reduction plan.

down in the past two years under the pressure of the Gramm-Rudman-Hollings budget law, public concern has eased. "People don't wake up in the morning and say, 'Oh my heavens, that deficit—I just can't go on.' "

But she and others [illegible]

I'm convinced that gold (which is a thoroughly international holding) sees this picture! Gold sees the US doing nothing on the deficit front -- doing nothing until the crisis hits. When the coming crisis hits, rates will tighten, business will panic, the bear will rule Wall Street again -- and the whole picture will turn deflationary. **So it's really the overhanging specter of deflation that is holding gold back.** I see this whole crisis picture materializing within a year -- but possibly even sooner -- possibly before the election.

Question: Russell, the week ending June 3 was the second biggest upside week (for the Dow) in market history. Couldn't this mean we are in a bull market?

Answer: I wish it did -- but it doesn't. The most difficult task I have in these reports is to convince people that major market trends are not haphazard or random. The great primary trend of the market does not turn bullish or bearish on the basis of news events, presidential edicts, new Congressional laws or easier Fed policies. Remember this -- once a bear market ends and a new bull market begins, that bull market will continue (regardless of news events) until stocks discount the best that can be seen ahead.

How does one know when the market is discounting the best? Answer: Volume is exploding, low-priced stocks are going through the roof, the public is in with both feet, rumors are flying, excitement is high, and the bull market is in its third speculative phase. But above all stocks become extremely overvalued.

Here's the other side of the coin -- once a bear market starts, stocks will decline (despite any and all news events) until the worst that can be seen ahead is fully discounted in the price structure.

How do we know when that is? Answer: Volume is low, a doom-and-gloom psychology prevails, stocks have collapsed, with the blue chips the last to go, bad news paints the tape, and the public (long gone) hates the very thought of Wall Street. The bear market is in its third liquidating phase. But above all, stocks have become great values. (For more on values, see a later section of this Letter.)

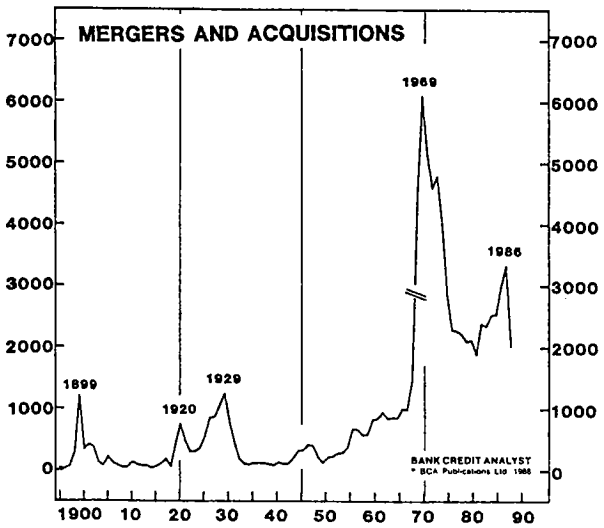
Note the kind of stock market news that you are now reading in newspapers or magazines or in the majority of advisory reports. Roughly 95% of what you read has to do with news and opinions such as interest rates, factory usage, corporate earnings, employment statistics, leading indicators, foreign buying or selling, currencies, etc.

How much do you read regarding the primary trend or the three phases of a bear market or historic values? Little or nothing. Yet a knowledge of the primary trend of the market is the single most important piece of information that any investor can possess. Any fool can buy stocks early in a bull market and make money. And any genius can buy stocks at the beginning of a bear market and lose his shirt.

Question: Russell, what about all the market technicians who are around today? Aren't they going to be right about the market? How do you see them affecting the situation?

Answer: The technicians are no different than any one else. Most of what you read in the technical reports has to do with the near-term, with what the market may do tomorrow or next week, with whether the stock market will have a good rally before election time.

Frankly, I haven't found the technicians any more aware of or knowledgeable about the primary trend than the economists. Few technicians understand anything about Dow Theory, the phases, yield cycles, values, or how to identify the major (primary) turns in the stock market. If they did, there would have been at least a few of them shouting "danger" last August, September, or October. If I remember correctly, I was the lone voice stating (October15) that the tide had turned and that a bear market was in progress (look up the October 15 *Barron's* at your library and count the number of openly bearish advertisements. I can save you the trouble -- there were none).

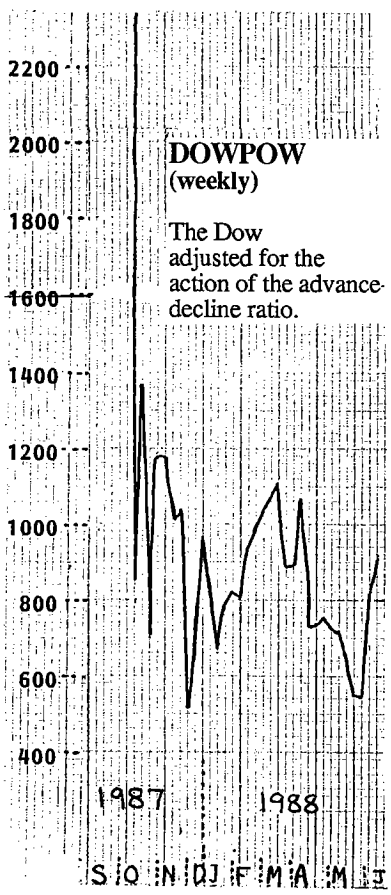


Incidentally, here is a most interesting chart from the current issue of the *Bank Credit Analyst* (514-398-0653) regarding the current super-charged merger atmosphere. States the *Analyst:* "If current trends continue there will be $250 to $300 billion worth of deals in 1988, almost double 1986's massive amount. The two other great equity manias of the 20th Century -- the 1920's and the 1960's -- also produced waves of merger activity. Both ended in terrible and prolonged bear markets and major regulation changes. It would be foolish to bet that the current mania will escape a similar fate. At a minimum, the heightened level of activity in 1988 is indicative of the late stage of a major bull market rather than the early phase of a new bull market." (My note: As I see it, the merger mania indicates that we are still in the first phase of the bear market, and it looks as though this first phase is going to be an extended affair -- it's already eight months old and business is still good and speculation is obviously still rampant in the merger and acquisition area.)

DOWPOW: After moving lower to touch its 89-day moving average, my PTI reversed itself and rallied to a new post-crash recovery high. Thus the intermediate trend of the market continues up.

This is a weekly chart of DowPow (Friday closings), and you can see that we have had a number of strong upside days in DowPow recently, but not enough of them to take DowPow above its series of post-crash peaks.

On May 23 DowPow failed by 10 points to break below its December 4 bear market low. Now DowPow is pushing at the high end of its eight-month trading range. Ultimately, DowPow will break out of its "prison" one way or the other. Every trading range has an end.



DOWPOW
(weekly)

The Dow adjusted for the action of the advance-decline ratio.

INVESTMENT POSITION: The bear still rules the box. Please read the section on Values in this Letter. After you read that section you'll realize that you and I, as investors, have two choices. (1) We can try to beat the bear by trading in and out of this bear market, attempting to catch the rallies and hoping to be smart enough to exit near rally tops. (2) We can sit on the sidelines and wait patiently for the bear to do his thing, the thing being to separate investors and traders from their bankrolls.

Now I'm not saying that you can't be successful with plan #1. I'm just saying that in my 40 years of experience in the markets I'd guess around 80% of the traders I've watched ultimately get taken by the bear. So for 80% of my subscribers I'm saying choose plan #2. It's a difficult and even frustrating plan, it's a plan that requires knowledge and patience and a definite commitment. But in the end I believe you'll come out ahead with plan #2.

For those of my subscribers who are pension plan mangers, corporate treasurers, portfolio managers, professional traders, you guys and gals are going to do your own thing anyway, and you probably read me simply to check against your own ideas and tactics. To you ladies and gentlemen, I don't have to say, "be careful." The bear will do that for me. And if you disagree with my stance, well, you can always confine your reading to the Notes & Quotes page and wait until I turn bullish again at the next bear market bottom.

VALUES: I don't know how many stock market advisories I read on a regular basis, maybe 30 of the better ones, but aside from *Dow Theory Letters* there are only two other advisories that I read that concentrate on values. The two are *Investment Quality Trends* here in La Jolla and *Growth Stock Guide*, Box 6600, Rapid City, SD 57709.

As all my subscribers know, the stock market moves in broad and extended waves which we call bull and bear markets. These waves are based on (1) changes in corporate earnings and (2) changes in stock buyers' expectations. When stock buyers are enthusiastic, they have, historically, driven the S&P 500 up to the point where it was selling at 29 or more times its dividends. On the other hand, when stock holders are pessimistic they have knocked the S&P 500 down to the point where it has sold at 15 or less times its dividends. These are the major value-perimeters that make for major bull or bear markets.

The following statistics are courtesy of *Growth Fund Guide* . The Dow is used from 1900 to 1925, and the S&P is used from 1926 to the present. Going back over market history, there were 11 periods when stocks sold at bargain levels of 15 or less times dividends. Those 11 periods are listed as follows (the first figure is the year, and the second figure is the price/dividend multiple): At the 1903 low stocks sold at 16 times dividends; 1907, 13; 1914, 15; 1917, 8; 1921, 11; 1932 a record low of 9; 1937, 12; 1942, 11; 1949, 14; 1974, 17; 1982, 15.

From each and every one of these bargain areas stocks rose. The average rise was 272%. The least rise was the 55% rise in the Dow following the 1937 low. The greatest rise was the spectacular 513% rise from the 1921 low.

What about prices at the highs? There were 15 cases in history when stocks pushed over the 29 times dividends level. In most cases stocks continued to climb to even more rarefied levels, but the 29 multiple represents the danger zone. And in each case (following the final upside push beyond the 29 price/dividend multiple) the stock market was in for trouble, important trouble.

The final high price/dividend multiples vary but only twice in history did the S&P sell as high as 38 times its dividends. The first instance occurred in January 1973. This was followed by a S&P 500 drop of 48.2% to a final low in December 1974. At that final

low the S&P was selling for a relative bargain price of 17 times dividends.

The second instance of a 38-to-1 multiple occurred in August 1987. Then came the crash. The S&P 500 dropped to 26.5 times its dividends at the October crash lows -- hardly a bear market bottom statistic but still a violent correction.

Since then the post-crash recovery has taken the S&P back to where at last week's highs the S&P 500 was selling at an overvalued 27.9 times dividends. What's happening? Buyers are again chasing over-priced stocks, a sign that the bear market remains in force (still in its first phase) and that investor sentiment is still very optimistic.

As I see it (and I've said this repeatedly), this is going to be one tough bear market. It will end (as bear markets always do) with investors darkly pessimistic -- pessimistic to the point where they will only be willing to pay around 15 or less times the S&P 500's dividends.

Unfortunately, the current post-crash rise in investors' hopes will only serve to prolong the bear market. Furthermore, it will only serve to bring in new sheep to be shorn. As for the bear, he loves the rally -- he loves anything that serves to lure new sheep into the fold.

Remember this -- bear markets don't end with informed buying and cries of "this is it, this is the bottom." No, bear markets end in desperation, in universal gloom, and in panic SELLING. When the last seller has dumped his wares, the bear market will be over. So far the only real selling we have seen occurred during last October. So it promises to be a long bear market. But those who are patient and who realize this -- will come out ahead in this toughest of all games.

A complimentary value study is provided by my friends at *IQ Trends* here in La Jolla. I have published updates of this chart many times in the past. *IQ Trends* carefully monitors 350 blue-chip stocks. Each stock possesses a different dividend history, and *IQ Trends* grades each stock monthly as to whether it is cheap or expensive on the basis of its dividend to current price.

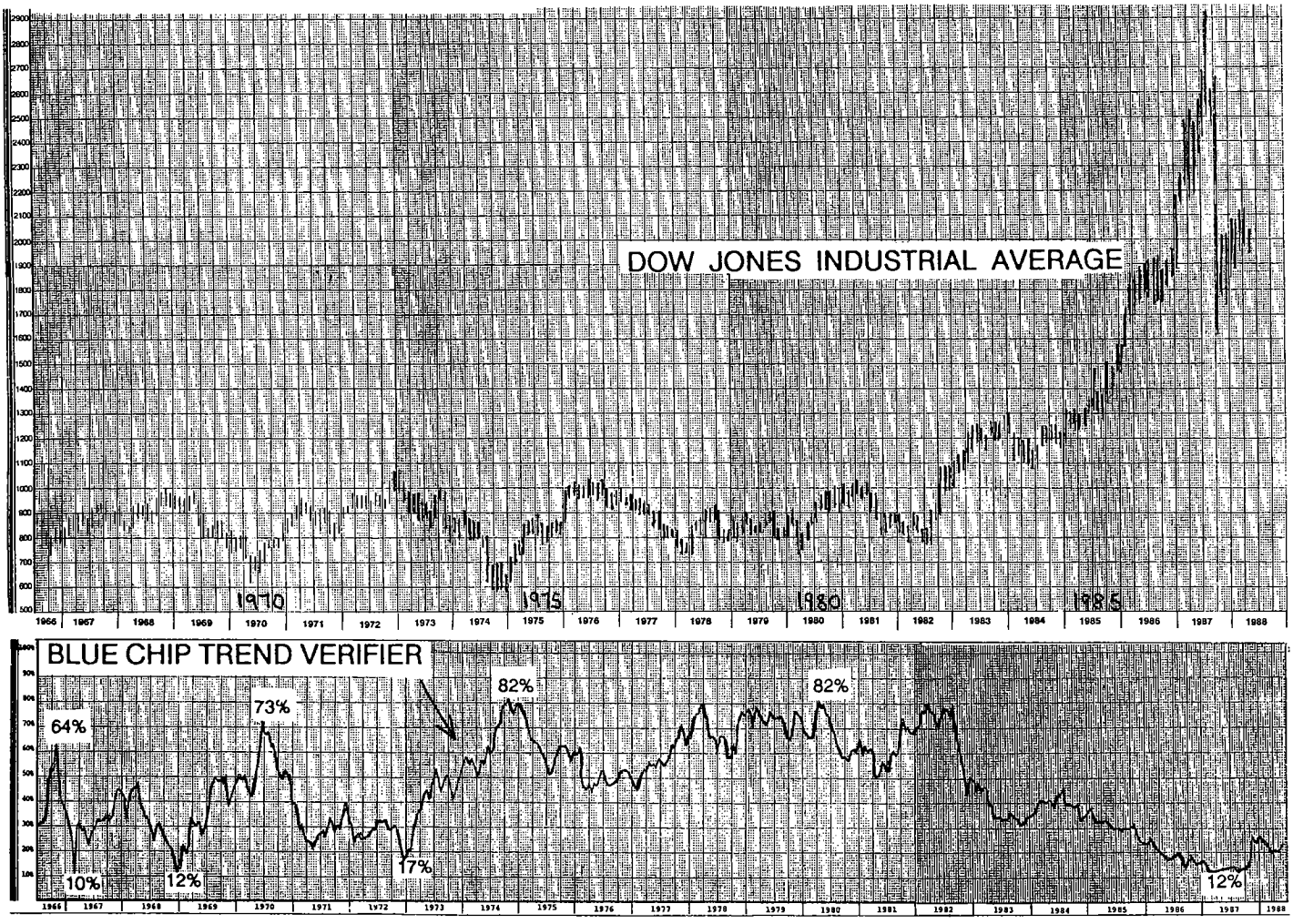
IQ Trends then calculates the percentage of its 350 blue-chippers that are currently undervalued. The result is a chart that has an extraordinary history of being able to identify major bull or bear market tops and bottoms. Note on the chart that bear market bottoms (bargain areas in which over 80% of the blue-chips were undervalued) occurred in 1970, 1974, 1980, and 1982. Top areas (in which only 17% or less of the blue-chips were bargains) occurred in early-1967, late-1968, late-1972, and last year in 1987.

Currently, only 23% of the blue-chips are in the undervalued area. As you can see on the chart, bear markets don't end with less than one out of four blue-chips in the bargain area. Bear markets end when around 80% of the blue-chips are bargains. To put it politely, we aren't there yet.

Rallies (even excellent rallies) will come and go, enthusiasm will wax and wane, presidents will come and go, business will rise and fall -- but one way or another this bear market will ultimately take stocks down to the point where 75% or 80% of the blue chips are in the "bargain basement" area. At that time, in that area, a new bull market will be born. And those with the brains, fortitude, and patience to possess capital at that time will sow the seeds of new fortunes to be.

GETTING IT DONE: There's more to life than making money. I've written that many times over the past 30 years, and evidently a lot of my subscribers believe it and want to hear more. So here's more . . . .

Gad, I can't believe it! When I started this business back in 1958 I never thought that some day I'd be writing Letter 1000, but it's



going to happen. It'll happen this September. A few days ago my wife Faye told me, "Anyone who can last 30 years in your business and write 1000 Letters, never missing a single Letter or deadline, must be doing something right." I answered, "I hope so, but to tell the truth I think my real achievement in this business is just staying sane."

How do you stay sane in the letter-writing business when you have to turn out a report every two weeks? Twenty years ago I would have answered facetiously, "You stay sane -- with great difficulty." But today I'll admit that writing the Letter has actually become a much easier task.

In the old days I would occasionally (actually quite often) get writer's "freeze." I describe that disease as the dis-ease one gets when there is a deadline to meet and one doesn't know whether they can meet it. Another way of describing this disease is "brain-cramp." You just don't know what to write about or whether you can write anything.

This same thing probably happens to many of my subscribers in other fields. How can you meet your quota of sales, how can you come up with the next advertising promotion, how can you produce a speech for the boss by Friday -- just how can you continue producing?

In my case, I have two aids. (1) Somewhere along the line I got religion, I really did, and I learned the meaning of the saying, "Let up, let God." In other words, when you get to an impasse, don't fight it, don't climb the wall, don't pull your hair out, don't shout at your wife. What you do (what I do) is let up, relax, realize that the task will get done, and it will get done on time. But you can't force it to get done. So let up, unclench your fists, and turn the whole problem over to a higher power.

Of course, a psychiatrist would say that what I am really doing is relaxing and letting my unconscious take over. The unconscious, by the way, is where 90% of the real power is. It's one's unconscious that delivers the inspiration, it's one's unconscious that produces the dreams, the ideas, the solutions to "impossible" problems. And many religious experts believe that the unconscious is one's real connection to God (via dreams, inspirations, ideas, etc.).

True or not, I have seen time after time where I am stuck, where I am in an impasse, where I can't make head nor tails out of the market, and I couldn't write about it even if I could figure it all out. I've seen over and over where if I just relax, let go, turn it all over to God or my unconscious mind, it all works out. That night or in the middle of the night or even next morning I will come up with "THE IDEA." Suddenly, the market makes sense to me. A light flashes on. I jump behind my Macintosh computer and start writing.

So here's the moral -- when you reach the impasse, when you've hit the stone wall, let up, and let God -- or relax, have a light beer, go to bed, and turn it all over to your unconscious mind. I'll guarantee the work will get done -- on time!

NOTES & QUOTES: The profits of the big Japanese banks are bordering on the grotesque. Have you wondered where the Japanese get the billions of dollars to buy out US firms? Here's part of the answer: Dai-Ichi Kangyo Bank Ltd., Japan's largest bank, had pre-tax profits for the year of $2.37 billion. Fuji Banks earned a pre-tax $2.28 billion. Sumitomo posted a pre-tax profit of $2.31 billion. Mitsubishi Bank Ltd. had a pre-tax profit of $2.26 billion. Sanwa Bank Ltd. had a pre-tax profit of $2.12 billion, and on and on.

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The growth champion of the world is now S. Korea. GNP was up 12% in each of the last two years, while inflation was held down to near 3%. S. Korea's astounding growth has been due to a number of factors; (1) they are workaholics, (2) they are building modern factories, (3) lower oil prices, (4) lower international interest rates, (5) rising price of the Japanese yen (which makes S. Korea more competitive. (6) Last but not least, putting highly-trained technocrats in key positions for running the economy.

* *

US Exports: Singapore now has 25 McDonalds outlets and 32 Kentucky Fried Chicken outlets. What's next? Probably cholesterol clinics.

* *

The rumor is that William J. O'Neill is losing $1 million a month on his fine business newspaper, *Investor's Daily*. How can he keep this up? Maybe by doing well in the market. O'Neill has his own system for picking stocks, and it may be a very good one. He uses four criteria which he calls "slim." S stands for shares; O'Neill wants stocks with fewer than 25 million shares outstanding. L stands for leaders; he wants stocks with good relative strength, stocks which are leading in the market. I is for institutional ownership; he wants stocks owned by 3 to 10 institutions. M stands for market; you must know whether you are in a bull or bear market. By using these strategies, O'Neill claims to have netted an amazing 40% annual return over the past 10 years. O'Neill has a new book out entitled, "How to Make Money in Stocks" (McGraw-Hill).

* *

Life in Gotham: Here are a few of the biggest condo sales in NYC for 1987: 721 Fifth Ave., Trump Tower, 11-room duplex for $5.5 million; 52 E. 52 St., 20-room triplex for $5.4 million; 721 Fifth Ave., 5-1/2 rooms for $3.1 million; 110 E. 71 St., 10 rooms for $3.1 million; 721 Fifth Ave., Trump Tower, 7-room duplex for $2.7 million, and on and on. In San Diego County (which is taking part in the current California home-buying craze) house prices are up 14% over the last 12 months.

* *

Old-time political observers are shocked at the plunge in Bush's popularity. What in the world is happening? (1) Women are not drawn to Bush. (2) Reagan's troubles are rubbing off on the Vice-President. (3) Bush doesn't seem to have any agenda and remains non-combative. (4) Bush comes across poorly on TV; he has a very unfortunate whiney delivery. When he attemps his "strong look," he looks strained and shrill.

From David Broder's column in the Washington Post: "Certainly, in my view, Bush has loafed into trouble in the two months since he assured himself the Republican nomination with his Super Tuesday sweep. He has been a passive witness to the unraveling of the Reagan administration -- the nasty 'insider' memoirs, the embarrassing impasse with Noriega, and the demeaning spectacle of Ed Meese's demolition of the Justice Department. And he has done nothing effective to put his own case or agenda before the people. Bush has not given a hint that he understands what the voters have on their minds. He appears not to grasp the shift in the polical climate, which has been clear since the Autumn of 1986."

At any rate, the political cartoonists are having a great time with poor George. Here's a typical example:

SOME PEOPLE WON'T THINK MY ENDORSEMENT OF GEORGE IS ENTHUSIASTIC...
...UNLESS I HIGHLIGHT HIS CONTRIBUTIONS OVER THE LAST SEVEN YEARS
WELL... GEORGE WAS THERE WHEN WE SOLD ARMS TO THE AYATOLLAH... WHEN WE STRUCK A DEAL WITH NORIEGA... WHEN ED MEESE NEEDED ADVICE...
GEORGE BUSH — MY BEST BUDDY — FROM BITBURG TO BEIRUT!!
BY WASSERMAN FOR THE BOSTON GLOBE

* *

Brokers: In 1982 there were 72,000 stockbrokers in the US. By 1987 the number had swelled to 93,000. During the same period the average earnings for brokers jumped from $82,926 to

$100,000. But the bear market is making inroads. Privately, brokers now concede that earnings in 1988 will be down 30 to 50 percent.

* *

An increasing number of intelligent and influential people are coming out for legalization of drugs. Recently, the New York County Lawyers' Assoc. endorsed legalization (nonprescription adult availability) of the main illegal drugs. The arguments are impressive. Each year 50,000 people are killed in alcohol-related accidents and car crashes and each year over 100,000 people die from lung cancer, much of it caused by cigarettes. Against this 7,000 people die each year from drug-related causes. Yet drug enforcement now costs the US $10 billion a year and imprisons 75,000 Americans. The history of prohibiting items which people want is not a good one. Alcohol prohibition, for instance, was a disaster. In the end, argue the legalizers, we must stop trying to protect people from themselves. People must live their own lives and take responsibility for their lives, tragic though those lives may be. Russell opinion: I'm fast coming to the opinion that money spent educating Americans to the danger of drugs is better spent than money spent losing the war on drugs (and we're losing it while the drug culture waxes fat with astronomical profits).

* *

The US's standard of living is sliding. The SOL Index (defined as gross domestic product per worker adjusted for inflation) droppped 21.1 points from 1972 to 1987. Last year W. Germany's SOL passed the US's at $34,400, vs the US's $28,400. Japan's was $23,200 and rising.

* *

If devaluing the currency was the road to riches, Mexico, Brazil, and Vietnam would be on top of the economic world. As a nation devalues its currency, it gets POORER in the eyes and the cash registers of the world. For instance, Mexicans can't buy a can of beans in the US with their mini-peso (as shop keepers here near the border know only too well). And Japanese and Europeans are beginning to find out the same thing about Americans. Historically, as a nation's currency goes (up or down), so goes its power. The Reagan Administration's decision to drop the dollar's value so that the US can sell its goods overseas may have been a short-term boost for our exports. In the end (Russell opinion), it will prove to be a disaster.

GOLD: Prices of everything else were going up -- from home prices to soybeans to platinum to BMWs -- so why not gold? Finally, on June 2, gold popped a fat $9.50 an ounce, to break about above the 460 level.

Now I'll let you in on a little secret. Unlike corn or hog bellies or lumber, gold isn't really subject to supply and demand in the sense that when more gold is produced the price automatically goes down and when too little gold is produced the price automatically goes up. No, gold tends to decline when people feel good about the world's condition or when people are unworried about inflation. After all, why hold a non-interest paying item when all's right with the world and you can own bonds paying 8% or 9% instead? Under such conditions, I don't care if half the gold mines in the world are shut down, people won't be bidding up the price of gold.

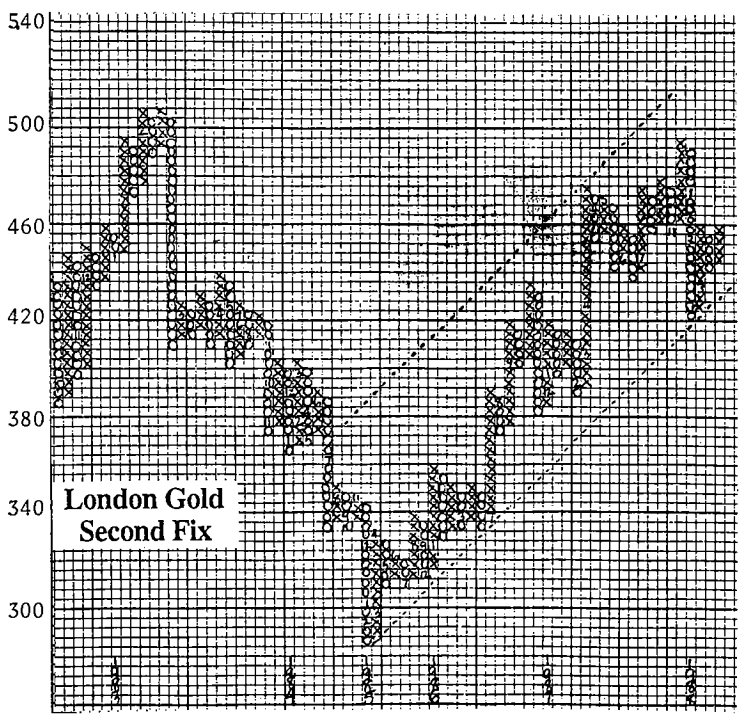
But change the conditions, let inflation heat up, let a big war start somewhere, let a major country default on its debt, let the world's banking system turn wobbly, and then watch gold. Under those conditions, all the gold mines in the world can be producing at capacity and gold will take off like a rocket.

Gold detracters tell us that gold production the world over is rising, going up maybe 16% in the next few years. And my answer to that is -- so what. The US is running deficits of $400 million a day (that's right, A DAY) and all that debt has to be paid off somehow and it's going to take money creation to pay it off (unless, of course, the US ultimately decides to choose bankruptcy). And that's just the US alone. Add to that the deficits being produced by other nations and I don't know what the daily totals would be.

And I know something else, and it's that gold isn't being produced at anything like $400 million dollars worth per day, and that means that the amount of outstanding debt is (daily) building up higher and higher against the world's supply of gold. So my point is -- don't tell me how much gold is being produced in the world, tell me how much credit is being produced in the world compared with the amount of gold being produced.

Maybe this chart is worth more than all the talk. Here we see a point & figure chart of gold (each box equals 4 points and rallies or declines of 12 points or more are shown). Note that since the February 1985 low of 284, gold has been moving within a rising channel. All fluctuations have been confined within this rising channel. Thus the major trend of gold is bullish.

Furthermore, figuring that 40 months have elapsed since February 1985 and that the price of gold is up roughly 180 points since that '85 low, we can say that gold has been rising at the average rate of $4.50 per month since early 1985. This is equal to a 63% rise since February 1985. That's about the same as the appreciation in the Dow since February '85, so we can say that gold has performed over the past three years about as well as the Dow -- no better, no worse.



LATE NOTES: In the stock market, sometimes it's the simple (but usually overlooked) items that tell you the most. For instance, study this series --- Dow hit 2027.85 on October 21 (two days after the market crash), Dow dropped, then rallied to hit 2051.89 on January 7, another decline and a Dow rally to hit 2087.37 on March 18. A third decline and a Dow rally to 2110.08 on April 12. A fourth decline and fifth Dow rally taking the Dow to a June 8 high of 2102.95.

The late, great Edson Gould used to say, "the market will try three times to penetrate a point. On the fourth try it will either make it in a big way or fail in a big way." We've now seen **FIVE** attempts by the Dow to close above the 2110 area.

In the mean time the Transports hit a high of 904.12 on March 23. They declined, then rallied to a (lower) 877.39 peak on June 10. So we have five Dow shots at 2110 accompanied by a lower peak on the Transports. On a cold reading of the Averages, trouble could be brewing (unless the Dow betters 2110.08 confirmed with a Transports bettering of 904.12).

NEXT MAILING: June 29